BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA'

In the Matter of the Appeal of)
)
'FLORENCE L. CUDDY)

Appearances:

For Appellant: Stephen E. Wall,
Attorney at Law

For Respondent: Burl D. Lack,
Chief Counsel

O P I N I O N

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Florence L. Cuddy against proposed assessments of additional personal income tax in the amounts of $21.13, $31.92, $23.01, $15.96, $227.69, $182.49, $628.31, $954.33, $1,902.23, $2,356.05 and $2,617.45 for the years 1949 through 1959, respectively.

In 1925 appellant's husband sold a portion of the Cuddy ranch.. The purchaser subdivided the parcel into approximately 800 lots, recorded the subdivision map, and sold several scattered lots'. In 1928 appellant and her husband, as joint tenants, reacquired the property through foreclosure, the buyer having defaulted on his obligation. From 1928 to 1947 the land lay dormant. Mr. Cuddy passed away in 1940.

In 1947 appellant commenced selling the lots and formed a mutual water company to service the tract. The following schedule reflects the number of lots sold by appellant during the years 1947 through 1959:

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Years	Lots Sold	Years	Lots Sold	Years	Lots Sold
1947-48	8	1952	22	1956	130
1949	28	1953	36		135
1950	18	1954	79	1957	
1951	18	1955	69	1959 1958	21 9 (9 repossessions)
			Total		573

Although she has never held a real estate license, appellant did virtually all of the selling herself. In 1953 she had a small office built on the subdivision site which she used in the conduct of her sales activity. She maintained a sign near the property reading "Mountain Lots--Cuddy Ranch Properties." In 1954 and 1955 she spent a total of approximately $900 on advertising. Most of the lots were sold on the installment basis, sometimes for as little as $10 down and $10 a month. Although she engaged in some farming, during the earlier years, appellant's principal activity was the sale of her lots. Appellant advanced over $96,000 to the water company during the years in question. Her returns for the years 1954 through 1959 claimed deductions for surveying, leveling and clearing land as follows: 1954, 1955 and 1956, $12,481.64; 1957, $9,517.54; 1958, $18,032.55; and 1959, $25,322.60.

Appellant's returns for the years in question reported the profits from the lot sales as capital gains, using a cost basis of $160 per lot. In her returns for 1949 through 1953, which were not filed until 1960, appellant elected to report the lot sales on the installment method and listed appellant's occupation as "farming." The returns for 1954 through 1959 were timely filed, reporting sales on the installment method, and listing appellant's occupation as "subdivider" or "real estate."

Appellant executed waivers for the years 1954 and 1955, extending the period for making assessments to April 15, 1961.

The Franchise Tax Board determined that appellant's profits from the sale of lots should be reported as ordinary income, that her cost basis should be reduced, and that appellant could not use the installment method of reporting for the years 1949 through 1953.

Section 17711 (now 18161) of the Revenue and Taxation Code, which is substantially the same as its federal counterpart (Int. Rev. Code of 1939, § 117; Int. Rev. Code of 1954, § 1221), provides that the term "capital asset" does not include property held by a taxpayer primarily for sale to.

customers in the ordinary course of his trade *or* business.

It is apparent that during the years in question appellant held her lots primarily for sale. Whether appellant's activities in relation to their sale amounted to a trade *or* business is an issue of fact and there is no *one* determinative test. (John D. Riley, 37 T.C. 932, aff'd, 328 F.2d 428.)

Appellant suggests that she was merely liquidating her property. No doubt, one may liquidate an asset in the most advantageous way and still obtain capital gains treatment, but a taxpayer is no less in the real estate business simply because the objective is to liquidate property. (Wchong Commissioner, 246 F.2d 445; Ehrman v. Commissioner, 120 F.2d 607, cert. denied, 314 U.S. 668 [86 L. Ed. 5341.) If the activities amount to the conduct of a business, a sale in the ordinary course of such business is not entitled to the preferred status accorded capital gains. (Home Co. v. Commissioner, 212 F.2d 637.)

A careful review of the record convinces us that appellant must be considered to have been in the real estate business. (Ehrman v. Commissioner, supra.) The large sums invested in improvements, the great number of and, at times,, very frequent sales, and the lack of other income producing activities all make it difficult to escape the inference that appellant was conducting a business. The self-descriptions of "subdivider" or "real estate" contained in appellant's returns are evidence of her business. (John D. Riley, supra.)

Appellant also relies upon sections 18197 and 18198 of the Revenue and Taxation Code which were enacted in 1955. (Stats. 1955, pp. 1807 and 1808.) Section 18197 provides that a lot or parcel which is a part of a tract of real property will not be deemed to be held primarily for sale in the regular course of business solely because of the taxpayer having subdivided it for purposes of sale or because of any activity incident thereto, if certain conditions are met. Appellant has failed, however, to demonstrate that these requirements have been satisfied.

One of the necessary'conditions is that no substantial improvement that substantially enhances the value of the land has been made by the taxpayer or a corporation controlled by him. (Rev. & Tax. Code, § 18197, subd. (b).) Respondent's regulations interpreting this provision state that among the improvements which will be considered substantial are "utilities such as sewers, water, gas, or electric lines." (Cal. Admin. Code, tit. 18, reg. 18197-18199, subd. (c)(4).) A water system was installed on appellant's land through a company formed by her and she has made no effort to establish that the installation was outside the meaning of the statute. She cannot, accordingly,

rely upon section 18197.

Neither is appellant aided by subdivision (c) of section 18198 which states that for the purposesof section 18197, the installation of certain improvements, including water facilities, will not be deemed to be a substantial improvement if it is shown to the satisfaction of the Franchise Tax Board that the parcel would not have been marketable at the prevailing local price for similar sites without such improvement, Appellant has not fulfilled this requirement. The last sentence of section 18198, waiving the above requirement in the case of property acquired through the foreclosure of a lien, is of no avail for any of the years in question since it was not enacted until 1961. (Stats. 1961, p. 2208.)

The Franchise Tax Board reduced appellant's 'cost basis per lot from $160 to $25 on the ground that appellant had not substantiated the larger amount. The substantiated amounts spent by appellant for surveying, clearing and leveling have been allowed in part as *current* expenses and the remainder has been added to the basis of the lots as being for capital improvements. Respondent's action is presumptively correct and appellant has, of course, the burden of proof. (Long v. Commissioner, 96 F.2d 270, cert. denied, 305 U.S. 616 [83 L. Ed. 392].) No evidence save appellant's own very general statements has been offered to support the $160 basis claimed for the property in question. Appellant's advances to the water company cannot be considered part of the basis for her lots. We, therefore, sustain respondent's action in this respect.

The installment method of reporting, which appellant seeks to adopt, provides a means whereby a taxpayer may report as income in any one year a portion only of the total gain realized from an installment sale. (Rev. & Tax. Code, §§ 17577, 17578, formerly §§ 17531, 17532.) The Franchise Tax Board argues that appellant's failure to file timely returns precludes her from utilizing this method for the years 1949 through 1953. In light of the recent liberalization of the rules in this area, we conclude that respondent is in error. (Baca v. Commissioner, 326 F.2d 189; F. E. McGillick Co., 42 T.C. 1059.)

Appellant contends that the assessments for the years 1954 and 1955 are invalid in that they were mailed more than four years after the returns were filed. We take official notice of the fact that the Franchise Tax Board has on file waivers signed by appellant extending the statute of limitations, with'respect to those years, to April 15, 1961. Since the notices of proposed assessment in question were dated February 3, 1961, it appears that they were timely. (See Rev. & Tax. Code, § 18589.)

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O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Florence L. Cuddy against-proposed assessments of additional personal income tax in the amounts of $21.13, $31.92, $23.01, $15.96, $227.69, $182.49, $628.31, $954.33, $1,902.33, $2,356.05 and $2,617.45 for the years 1949 through 1959, respectively, be and the same is hereby reversed with respect to the question of installment reporting for the years 1949 through 1953. In all other respects the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 12th day of May, 1965, by the State Board of Equalization.

John W. Lynch, Chairman

Paul R. Leake, Member

Geo. R. Reilly, Member

_____, Member

_____, Member

Attest _____, Secretary